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Largest shareholder and dividend policy around the world

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Abstract

This paper examines the interaction between the largest shareholder and dividend policy in a sample of 8,279 listed firms drawn from 37 countries. We find that firms are more likely to pay dividends when profitability is high, debt is low, investment opportunities are limited or when the largest shareholder is not an insider. Further, the magnitude of dividend payout tends to be smaller when the largest shareholder is either an insider or a financial institution. It is also apparent that largest shareholding and dividend payout are related and that, consistent with the extant literature, legal system does matter in dividend policy decisions.

JEL classification: G32; G34; G35

Keywords: Ownership; Largest shareholder; Dividend policy; Legal system

1. Introduction

Berle and Means (1932) claimed that ownership structure was widely dispersed, but this is not the case, particularly for firms located outside the US and the UK. There is increasing evidence of concentrated shareholding, with the majority of equity in a firm held by one shareholder or a shareholder group (La Porta, Lopez-deSilanes, & Shleifer, 1999 for developed country firms; Becht & Mayer, 2000 for European firms; Claessens, Djankov, & Lang, 2000 for East Asian developing firms). Indeed, we find that at least 50% of the firms in our sample, drawn from 37

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countries, have one shareholder or a shareholder group owning at least 25% of the equity in the firm,[1] with the largest shareholder holding more than 30% of total voting shares on average.

The largest shareholder is a quite distinctive class of shareholder. Their investment is sensitive to firm decisions and there are costs associated with maintaining such a large investment in a firm, particularly the cost of under-diversification. But, there are also benefits arising from the influence that such shareholders exercise over the firm (Claessens, Djankov, Fan, & Lang, 2002). While the ownership literature is substantial, there are some gaps in this literature and the role of large shareholders, especially the largest shareholder, is not well developed (Holderness, 2003). In this paper, we focus on the impact of the largest shareholder on firm dividend policy in an effort to gain a better understanding of what role the largest shareholder might play in setting dividend policy.[2] Large shareholders could exert pressure on a firm to adopt a dividend policy that reduces private consumption by firm management yet they could also enforce a dividend policy that maximizes private benefits for them at the expense of minority shareholders. It is important to analyse the relationship that exists between large shareholders and dividend policy if we are to better understand the dividend policy decision.

Few studies have examined the effect of the largest shareholder on dividend policy, and these studies are largely single country-based, including Gugler (2003) for Austrian firms and Correia Da Silva, Goergen, and Renneboog (2004) for German firms. Research dealing with the relation between management ownership and dividend policy (Jensen, Solberg, & Zorn, 1992; Rozeff, 1982) is more apparent as is analysis of the relation that exists between institutional ownership and dividend policy (Barclay, Holderness, & Sheehan, 2006; Grinstein & Michaely, 2005; Short, Zhang, & Keasey, 2002). Agency theory suggests that the largest shareholder and dividend policy might be viewed as substitute monitoring devices (Easterbrook, 1984; Jensen, 1986; Rozeff, 1982).

In examining firm dividend policy, there are two key decisions; (i) whether or not to pay dividends, and (ii) how much to pay. Following Fama and French (2002), we extend the model of Lintner (1956) assuming that the so-called “target” dividend payout rate is a function of firm leverage and investment opportunities. Unlike previous studies, we also examine the potential effects of heterogeneity in the largest shareholder on dividend policy. Different types of the largest shareholder (insider, financial institution or state) differ in terms of their preferences and desires as well as in their ability to influence firm management and hence dividend policy (Gugler & Yurtoglu, 2003; Renneboog & Trojanowski, 2005).

Dividend policy is observed to vary across countries and legal systems (La Porta, Lopez-deSilanes, Shleifer, & Vishny, 2000b) and so we choose cross-sectional data for 8,279 large firms drawn from 37 countries around the world, with annual reports available in 2004. We examine cross-sectional variations in dividend policy, and the impact of largest shareholder on this policy choice. We split the analysis between dividend paying and non-dividend paying firms, as well as specifically allowing for different legal systems (common law vs. civil law). Further, it is possible that while the largest shareholder could influence dividend policy, it is also feasible that dividend policy affects the ownership level that the largest shareholder chooses. For example, Grinstein and Michaely (2005) argue that dividend payout may affect firm ownership. It is feasible that firm

[1] These firms are rated with the OSIRIS independence indicator B or C, meaning that they have at least one shareholder whose shareholding exceeds 25% of the firm. A detailed discussion of OSIRIS data appears in later sections.

[2] There is still considerable controversy over the question of just why firms pay dividends. For example, Renneboog and Trojanowski (2005, p. 2) note that “the controversy about why firms should pay dividends has not been satisfactorily resolved”.